an integral part of, or inseparable from, transmission.[365] The use of LEC central office space is an integral part of expanded interconnection through physically collocation and is necessary to complete calls using this form of interconnection.[366] Without access to this space, interconnectors could not make use of physical collocation for the carriage of interconnected communications, and transmission of common carrier communications could not take place.[367]

163. Moreover, we conclude that LEC central office space offerings for physical collocation constitute common carriage. We are specifically requiring that the LECs make expanded interconnection available to all

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365 For example, the Commission has determined that calling card validation information is "incidental to" communications service under Section 3(a) of the Communications Act. 47 U.S.C. 153(A). See Policies and Rules Concerning Local Exchange Carrier Validation and Billing Information for Joint Use Calling Cards, 7 FCC Rcd 3528, 3531-32 (1992), pet. for recon. pending, pet. for review pending, Capital Network System Inc. v. FCC (D.C. Cir., filed June 14, 1991) (LEC validation and screening services are "not severable from the underlying local exchange transmission service" and are a "byproduct of [the LECs'] local exchange service"). See also Cincinnati Bell Tel. Co., 5 FCC Rcd 805, 808 (1990), 6 FCC Rcd 3501, 3504 (1991), pet. for recon. pending; Graphnet Systems, Inc., 73 FCC 2d 283, 287-90 (1979).

366 Like the telephone numbers used in LEC credit card screening and validation services, the ability to provide central office floor space for expanded interconnection is incidental to the LECs' provision of local exchange and access services.

367 The provision of central office space for physically collocated expanded interconnection differs in important respects from the leasing of pole attachment space for cable television. In California Water and Tel. Co., 64 FCC 2d 753, 758-60 (1977), we held that utility pole attachments (including those of telephone companies) offered to cable television operators were too remote from cable television service to be considered incidental to transmission. In contrast to this, the provision of central office space is intimately related -- indeed, is indispensable -- to physically collocated expanded interconnection, and thus to the actual transmission of common carrier communications. While pole owners were not themselves involved in cable television transmission, id. at 759, a LEC providing central office space as part of expanded interconnection is in fact itself involved in the actual transmission of common carrier communications by virtue of the interconnection with the LEC's local exchange transmission facilities. Under physical collocation, the LEC-provided cross-connect between the interconnector's equipment and the LEC distribution frame is indisputably a common carrier communications service. Without space in the LEC central office for the location of its equipment, an interconnector cannot make use of the cross-connect. Therefore, the provision of central office space for purposes of expanded interconnection properly must not be viewed in isolation, but rather as an integrated component of the overall expanded interconnection service.

interested parties on a nondiscriminatory basis, regardless of their status as CAPs, IXCs, or end users.[368] The nondiscriminatory provision of expanded interconnection through physical collocation requires that LECs offer central office space to all interconnectors, rather than making individualized decisions whether and on what terms to make this offering available. Central office space for physical collocation can therefore be distinguished from other types of offerings, which courts and the Commission have held need not be tariffed because they can be provided separately from communications offerings, can be provided competitively by non-carriers, or can be offered on the basis of individualized decisions whether and on what terms to deal. For example, unbundled offerings of customer premises equipment (CPE),[369] enhanced services,[370] inside wiring,[371] and billing and collection[372] have been deemed not to be "common carriage" on such grounds. By contrast, space usage for physical collocation is necessary for transmission over interconnected circuits using fiber optic and microwave technologies, can be provided only by LECs, and must be offered on a generally available basis. No competing space provider can offer space that would make possible the ubiquitous interconnection to the remaining, non-competitive portions of the LEC networks. Accordingly, we find that the public interest requires that the subject LECs provide floor space and associated power and other utilities

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368 See supra ¶ 65. Offering expanded interconnection on a non-common carrier basis could thwart achievement of our objectives in this proceeding and constitute an unjust and unreasonable discrimination.

369 See Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Final Decision, 77 FCC 2d 384, 450-51 (1980) (holding that the Commission has legal authority to require that CPE be detariffed and unbundled from tariffed communications, even though the Commission would have authority to tariff CPE offered in conjunction with communications), recon., 84 FCC 2d 50, 98-105 (1981), aff'd sub nom. Computer & Communications Indus. Ass'n v. FCC, 693 F.2d 198, 210 (D.C. Cir. 1982) (Commission's decision was reasonable in light of "the severability of CPE from transmission services and the competitive nature of the CPE market"), cert. denied, 461 U.S. 938 (1983).

370 See Second Computer Inquiry, Final Decision, 77 FCC 2d at 420-21, 428, 430-35, recon., 84 FCC 2d at 54; 47 C.F.R. § 64.702 (defining enhanced services).

371 Detariffing the Installation and Maintenance of Inside Wiring, 1 FCC Rcd 1190, 1192 (1986), recon., 3 FCC Rcd 1719 (1988), rev'd in part sub nom. National Ass'n of Reg. Util. Comm'rs v. FCC, 880 F.2d 422, 428-30 (D.C. Cir. 1989) (reversing preemption of state regulation, but affirming use of Commission's "ancillary" authority to detariff inside wiring in order to encourage competition).

372 Detariffing of Billing and Collection Services, 102 FCC 2d 1150, 1168, recon. denied, 1 FCC Rcd 445 (1986), judicial review denied sub nom. Public Serv. Comm'n of Maryland v. FCC, 909 F.2d 1510, 1513-14 (D.C. Cir. 1990).

on a non-discriminatory, common carrier basis.[373]

## E. LEC Special Access Offerings

### 1. Pricing and Rate Structure Flexibility for LEC Special Access Offerings

**164.** Notice. We stated that with the advent of competition, the LECs may need added rate structure flexibility to compete for special access traffic, but added that we might wish to proscribe certain forms of competitive response as unfair.[374] We asked for comment on whether guidelines should be developed for review of LEC rate structure responses to competition such as volume discounts, distance-sensitive pricing, and differential pricing of customer premise-to-end office (loop-side) and end office-to-IXC POP (trunk-side) links. We stated, however, that we did not propose to change the rate bands currently applicable to the LECs' DS1 and DS3 offerings.[375] We requested comment on whether the LECs should be accorded additional pricing flexibility for DS1 and DS3 services at some point in the future.[376]

**165.** Comments. The LECs argue that if the Commission orders expanded interconnection for special access, it should grant the LECs additional pricing and rate structure flexibility to respond to competition. The LECs advance various proposals for flexibility, although most support some combination of the following: (1) customer-specific service offerings[377] or responses to competitive bids;[378] (2) geographic rate

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373 National Ass'n of Reg. Util. Comm'rs v. FCC, 525 F.2d 630, 641 (D.C. Cir.), cert. denied, 425 U.S. 992 (1976). Using this reasoning, the Commission has determined that calling card validation information and a physical delivery service are subject to Title II regulation. Graphnet Systems, Inc., 73 FCC 2d 283, 287-90 (1979) (both electronic transmission and physical delivery portions of a Mailgram-type service were common carrier communications service subject to Title II). See also Cincinnati Bell Tel. Co., 5 FCC Rcd 805, 808 (1990), 6 FCC rcd 3501, 3504 (1991), pet. for recon. pending.

374 Notice, 6 FCC Rcd at 3266, ¶ 45.

375 Id. at 3268, ¶ 59.

376 Id. at ¶ 60.

377 See, e.g., NYNEX Comments at 36, 44-45; Bell Atlantic Comments at 7; Pacific Comments at 43; Ameritech Comments at 39; BellSouth Comments at 42-43; GTE Comments at 22, 49; Cincinnati Bell Reply Comments at 7-9; USTA Comments at 59; SW Bell Reply Comments at 31-32 & App. E at 9-14 (proposing designation of "Competitive Market Segments" where LECs do not have market power and could enter individual case basis arrangements or contracts supported by filed tariffs effective upon 14-day notice).

differentials;[379] (3) differential pricing of loop-side and trunk-side channel terminations;[380] (4) elimination (or relaxation) of the price cap banding constraints on DS1 and DS3;[381] and (5) streamlined tariff review to facilitate timely LEC competitive responses.[382]

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378 See, e.g., Ameritech Comments at 39; BellSouth Comments at 42-43. Some LECs support individual case basis pricing authority, but state that volume discounts are a second-best way to accomplish similar results. NYNEX Reply Comments at 20 n.39. See also Centel Comments at 4; Rochester Comments at 28.

379 All of the larger LECs support some form of geographic rate differentials. United specifically proposed creating a number of zones based on traffic density within given study areas, with averaged pricing in each zone. United Comments at 16-21; United Reply Comments at 6-9; United Ex Parte at 1-3 (Sept. 9, 1992). USTA, SW Bell, and NYNEX made similar proposals. SW Bell Ex Parte at 16-22 (July 8, 1992) (advocating creation of Competitive Market Areas (CMAs) where LECs could reduce rates by up to 15% pursuant to separate price cap subindexes, and could respond to competitive offers with individual case basis contracts; and Transitional Market Areas, where existing price cap rules would apply); USTA Ex Parte (July 1, 1992) (same proposal); NYNEX Ex Parte at 2-16 (Aug. 20, 1992) (similar proposal, except banding limits would be eliminated in CMAs). See also Ameritech Comments at 21, 39; NYNEX Comments, Exh. F at 2-3; Bell Atlantic Comments at 7-8; Bell Atlantic Reply Comments at 9; Pacific Comments at 43-48; BellSouth Comments at 37-39; BellSouth Ex Parte at 3 (Sept. 10, 1992); GTE Comments at 22, 46-49; GTE Reply Comments at 33-37; SNET Comments at 18; Cincinnati Bell Reply Comments at 5-7; SW Bell Reply Comments, App. C at 11; U S West Reply Comments at 51-54.

380 Bell Atlantic Comments at 7 n.16; Pacific Comments at 46.

381 See, e.g., Pacific Comments at 32-34; BellSouth Comments at 39; USTA Comments at 59; GTE Comments at 49 (supporting elimination of bands constraining special access basket); Ameritech Comments at 40 (arguing for redefinition of subindexes based on functional categories rather than the current product line definitions); Bell Atlantic Comments at 5; Bell Atlantic Reply Comments at 10 (citing criteria for loosening regulation of AT&T in Interexchange proceeding). SW Bell proposes eliminating the four service categories and the DS1 and DS3 subindexes, and instead creating geographic zone classifications based on cost, market, and volume differentials, each of which would have a price index. The upper and lower banding ranges would be widest in the zone subject to the most competition, and progressively narrower in less competitive zones. SW Bell Reply Comments, App. E at 15-19.

382 See, e.g., BellSouth Comments at 35-36; GTE Comments at 49; USTA Comments at 60; Cincinnati Bell Reply Comments at 11-13; Centel Comments at 4; Bell Atlantic Comments at 9 (proposing 14-day notice for effectiveness of new or repriced special access services); Pacific Comments at 33-34; Ameritech Comments at 39-41 (arguing for one day notice).

166. The LECs argue that allowing CAPs to compete freely while restraining LEC flexibility would create an unfair and unnecessary price umbrella that would protect competitors and deprive customers of the benefits of competition.[383] They contend that even a short delay in granting them pricing flexibility would make it economically necessary for large IXCs and business users to construct their own transmission facilities or use the services of a CAP.[384] Many of the LECs say that, even in the absence of pricing limits, they could not successfully engage in predatory pricing since the IXCs could avoid excessive rates by taking advantage of expanded interconnection directly even if a LEC succeeded in driving CAPs out of the market.[385] These LECs argue that if long run incremental cost (plus any contribution element charged to interconnectors) is the price floor, the market ultimately will dictate the price ceiling.[386] NYNEX and Rochester submit that LECs should be permitted to raise rates for DS1 and DS3 services by up to 25% annually, and to lower them to incremental costs on an individual case basis.[387]

167. The CAPs and the IXCs generally argue that the LECs already have substantial pricing flexibility under price caps, and that until additional competition for both switched and special access has developed, no further flexibility is appropriate.[388] These parties express concern that the LECs will exploit their monopoly service customers and engage in anticompetitive practices to thwart entry. Several IXCs say that the pricing flexibility requested by the LECs would permit LECs to discriminate against small IXCs in areas where competition is weakest. They argue that pricing flexibility is inappropriate because local access competition has not yet

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383 See, e.g., Pacific Reply Comments at 21-32; SW Bell Reply Comments at 30-50; GTE Reply Comments at 42-49; USTA Reply Comments at 6-7, 23-27; Ameritech Ex Parte at 15 (Sept. 1, 1992).

384 See, e.g., NYNEX Reply Comments at 7-9; SW Bell Reply Comments at 39.

385 See, e.g., NYNEX Comments at 45; Pacific Comments at 41-42; BellSouth Comments at 40-41; Bell Atlantic Reply Comments at 10-11; Rochester Reply Comments at 22-23; SW Bell Ex Parte at 9-11 (July 8, 1992).

386 See, e.g., SW Bell Comments, App. C at 7-8 & App. E at 2; USTA Reply Comments at 30.

387 NYNEX Reply Comments at 20 n.39; Rochester Comments at 28.

388 See, e.g., MFS Comments at 87-100; Teleport Comments at 53-56 (opposing, inter alia, trunk/loop price differentials); ICC Comments at 21-22; ICC Reply Comments at 3-5, 10-11; Teleport Denver Comments at 11, 13; Allnet Comments at 6; CompTel Comments at 19-22; AT&T Reply Comments at 8-10; MidAmerican Reply Comments at 6; WilTel Comments at 29; Sprint Reply Comments at 6-7.

developed sufficiently.[389] Some CAPs and IXCs also oppose geographic differentials in special access rates, saying that the Commission would be unable to determine the LECs' costs for services offered on a geographically disaggregated basis.[390] WilTel, arguing that LECs will not voluntarily use pricing flexibility to rationalize the distance sensitivity in their special access rate structures, supports United's cell density plan insofar as it addresses underlying cost differences directly.[391]

**168.** MCI states that special access rates grew out of charges developed on an individual case basis and have never been required to meet any cost showing other than that the rates as a whole cover fully distributed costs.[392] MCI argues that the Commission should require the LECs to base special access rates on total service long-run incremental cost (TS-LRIC) studies, which measure the LEC's cost of providing an entire service and prevent a service from receiving subsidies from other services.[393] Several IXCs say that special access is identical to dedicated transport and directly related to common transport, and argue that consistent pricing guidelines should be applied to all the services.[394]

**169.** Users advance similar concerns about LEC pricing flexibility, arguing that pricing flexibility not be permitted until expanded interconnection is in place and a degree of competition has developed.[395] Some users, however, support downward, but not upward, pricing flexibility, and individual customer arrangements analogous to those offered by AT&T in its Tariff 12, in locations where competitors are offering service using expanded interconnection arrangements.[396]

**170.** NTIA and Justice argue that additional LEC pricing flexibility is appropriate,[397] although Justice would permit such

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389 See, e.g., CompTel Supp. Reply Comments at 7-9; MCI Supp. Reply Comments at 5.

390 See, e.g., ICC Reply Comments at 5-7; MCI Supp. Reply Comments at 4-5.

391 WilTel Supp. Reply Comments at 12.

392 MCI Supp. Comments at 4-5.

393 MCI Supp. Comments at 3, 6-7.

394 See, e.g., WilTel Supp. Comments at 2.

395 See, e.g., Ad Hoc Comments at 33-35; Ad Hoc Reply Comments at 5-13; Bankers Comments at 18-19; ICA Comments at 18.

396 See, e.g., Ad Hoc Reply Comments at 12-13; Bankers Reply Comments at 12-17; GSA Comments at 16-17.

397 NTIA Reply Comments at 17.

flexibility only for trunk-side connections (central office to IXC POP and interoffice links) subject to competition. Justice specifically proposes separate price cap subindexes for the competitive trunk-side transmission elements and the less competitive loop-side transmission (customer premise to central office) and connection charge elements.[398] The SBA opposes granting LECs any pricing flexibility beyond that already permitted under the price cap rules.[399]

171. Most of the state commissions contend that premature relaxation of regulatory safeguards could stifle the development of competition. As a result, they argue that the LECs should only be given additional pricing flexibility when and where substantial competition has developed, and that the LECs should not be allowed to reduce rates for customers who are subject to CAP competition and increase rates in non-competitive markets.[400] Illinois, on the other hand, supports immediate LEC pricing flexibility to respond to special access competition.[401]

172. Discussion. As the provision of special access becomes more competitive, marketplace forces should drive prices closer to cost. Care must be exercised, however, in the regulation of LEC pricing during the period of transition from monopoly to competition. This is particularly true when certain LEC services are subject to much greater competitive pressure than others. Excessive constraints on LEC pricing and rate structure flexibility will deprive customers of the benefits of competition and give the new entrants false economic signals. At the same time, inadequate restrictions on LEC special access pricing and rate structure could permit competitive abuses, stifling competitive entry and placing excessive cost burdens on customers of less competitive services.

173. Under the existing price cap rules, the LECs already possess a certain degree of pricing and rate structure flexibility. They can change their rates subject to the constraints imposed by the price cap index, applicable pricing bands, and the requirement for an average variable cost showing for below band rate reductions. The rules also permit the LECs to institute volume and term discounts for special access, and to adjust the distance sensitivity of their rates.[402]

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398 Justice Reply Comments at 50-51, 53-56 (proposing, among other things, that when expanded interconnection becomes effective, the LECs should be allowed to deaverage rates of competitive trunk-side special access, both on a distance-sensitive and geographic basis, and supporting removal of downward limits on the price cap pricing bands for such services).

399 SBA Comments at 32-33.

400 See, e.g., Florida Comments at 14-15; New York Comments at 11-13; D.C. Reply Comments at 3-5.

401 Illinois Comments at 12-13.

402 See infra ¶¶ 199-203, 212-15.

174. The Part 69 rules, however, require rate averaging at the study area level.[403] Competitors entering the interstate access market have generally targeted areas where the economic cost of providing service is well below the LECs' averaged rates. At a minimum, we believe that, with mandatory expanded interconnection, the Tier 1 LECs should be allowed greater freedom to adjust their rates to reflect traffic-density-related cost differences.

175. The cost of providing special access services includes two basic elements: (1) the cost of the central office electronic equipment (and related overheads, including central office buildings); and (2) the cost of fiber optic or copper cable, rights of way, conduit, repeaters and other distance-sensitive items. Traffic density appears to be a very significant factor affecting the cost of both elements. The greater the number of channels carried by a given cable, fiber strand, or electronics unit, the lower the unit costs of the equipment.[404] Traffic density is greater, and costs lower, in most central city areas where large concentrations of high volume customers are located, than in most suburban or rural areas.[405] Similarly, traffic density is likely to be greater, and costs lower, on routes that involve greater traffic aggregation, such as routes to IXC POPs, than on most loop-side routes to individual users.[406]

176. Illinois, New York, and Massachusetts, states in which intrastate expanded interconnection arrangements already exist, have also granted the LECs certain pricing flexibility. In orders dating back to 1983, the Illinois Commerce Commission has permitted Illinois Bell to set rates for residential and business local exchange service, as well as Centrex and private line service, based on three density pricing zones: (1) downtown Chicago; (2) the remainder of Chicago and some of the contiguous suburbs; and (3) the rest of the state. Rates are averaged within each area but are lower

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403 47 C.F.R. § 69.3(e)(7). A study area generally consists of a telephone company's operating territory within a given state, although there are certain cases in which companies have multiple study areas in a state.

404 This is an example of the well-known phenomenon of decreasing costs, or economies of scale. See, e.g., 1 A. Kahn, Economics of Regulation: Principles and Institutions 124 (1970).

405 The greater reliance on copper transmission facilities in rural areas, with their significant distance sensitivity, also supports the conclusion that service is more costly to provide in rural areas with greater transmission distances. See United Comments at 16-21 & App. 3; United Reply Comments at 6-9; GTE Reply Comments at 33-37 & App. A.

406 Distance also affects the costs of fiber optic cable. Although the cost of fiber optic facilities is clearly less distance sensitive than copper transmission plant, fiber optic facilities do have a distance sensitive component. See infra ¶¶ 212-15, for a discussion of distance sensitivity issues.

in the more urban areas.[407] New York granted pricing flexibility in the same orders requiring expanded interconnection for special access and switched transport, respectively, permitting New York Telephone to offer individual case basis prices for access services subject to competition in wire centers where interconnectors are present, in response to customers' requests for proposals.[408] Massachusetts, in its Intra-LATA Competition order, permitted New England Telephone to lower prices for competitive services to an incremental price floor and to increase rates for inelastic services gradually.[409]

**177.** Retaining the current degree of pricing and rate structure flexibility would be consistent with our past determination that the price cap system gives the LECs sufficient freedom to reprice their services. Our past statements regarding price caps could not, however, have taken into account either current market conditions or the significantly increased potential for competition made possible by expanded interconnection. For example, in the financial district in southern Manhattan, CAPs already provide a substantial portion of all DS1 and DS3 special access circuits.[410] Although some parties suggest that we delay any increase in LEC special access pricing flexibility until competition has developed further, competition is already developing relatively rapidly in the urban markets and will only accelerate with the implementation of expanded interconnection. Thus, delay in providing LECs with any additional pricing flexibility appears unwarranted. This is particularly true with regard to the current study-area-wide rate averaging, which forces the LECs to price above cost in the urban areas where competition is most intense.

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[407] Revenue Requirements and Rate Levels for the Illinois Bell Tel. Co. and its Successor Organizations Effective on the Date of Divestiture, Dockets 83-0005 and 83-0669, at 54-55, 74 (Ill. Commerce Comm'n, Dec. 21, 1983) (density zones for residential and business local exchange network access rates); Illinois Bell Tel. Co. Proposed Restructuring of Centrex Service, Docket 84-0111, at 6 (Ill. Commerce Comm'n, Sept. 12, 1984) (density zones for Centrex rates); Illinois Bell Tel. Co. Proposed New Calling Rate Plan, Dockets 85-0364 and 86-0022, at 13-14, 49-50 (Ill. Commerce Comm'n, June 25, 1986) (density zones for private line rates).

[408] Regulatory Response to Competition, Opinion No. 89-12, Case 29469, at 28 (N.Y. PSC May 16, 1989); Pooling, Collocation and Access Rate Design, Opinion No. 92-13, Case 28425, at 65-66 (N.Y. PSC May 29, 1992).

[409] Intra-LATA Competition, D.P.U. 1731 (Mass. Dept. Pub. Util., Oct. 18, 1985); New England Tel. & Tel. Co., D.P.U. 89-300 (Mass. Dept. Pub. Util., June 30, 1990). Unlike Illinois and New York, however, Massachusetts has continued to require New England Telephone to price its services on a geographically averaged basis.

[410] NYNEX Reply Comments at 7 & n.11 (CAPs have over 40% of high capacity market in New York state, with higher market share in Manhattan south of 59th Street). See also USTA Reply Comments at 7-8 (asserting that Bell Atlantic provides only 56% of DS3 services in its operating areas).

178. Retention of study-area-wide rate averaging could create a pricing umbrella for the CAPs and deprive customers of the benefits of more vigorous competition. It could also undermine efficiency by preventing the LECs from competing effectively even when they are the low cost service provider. Handicapping the LECs in this fashion could also increase their competitive losses under expanded interconnection, bringing upward pressure to bear on LEC rates for less competitive services, including those used by residential customers.

179. We will therefore change our rules to expand the LECs' flexibility in responding to competition. In particular, we will allow LECs with operational expanded interconnection offerings to implement a system of traffic density-related rate zones to bring special access rates more in line with costs.[411] We will continue to require that rates for special access services subject to competition[412] be averaged within each zone, but we will permit rates for such services to differ between zones. Each LEC may establish a number of density pricing zones[413] within each existing study

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411 An expanded interconnection offering will be deemed to be operational for this purpose when an interconnector has taken the expanded interconnection cross-connect element. See supra ¶ 157 (definition of cross-connect element). We believe that this is a reasonable point for permitting implementation of additional LEC pricing flexibility since the interconnector will first become able to serve customers when they take the cross connect. Use of expanded interconnection under the interim expanded interconnection tariffs required to be filed by certain LECs, see infra ¶ 262, does not satisfy this requirement, however. LECs that voluntarily offer expanded interconnection in compliance with the standards adopted in this Order are eligible to implement the pricing flexibility measures we are adopting.

412 A service will be deemed subject to competition if interconnectors have provided service of that type over their own circuits using expanded interconnection. For this limited purpose, interconnector resale of LEC transmission services will not be considered to constitute competition. Under this definition, we deem DS1 and DS3 special access services to be subject to competition. LECs may, by an appropriate showing, demonstrate that additional special access services are subject to competition. We delegate authority to the Chief, Common Carrier Bureau to determine when LEC services are subject to competition for this purpose.

413 While we are not limiting the number of zones, we believe that the use of up to three pricing zones would allow the LECs ample opportunity to reflect cost differences among major metropolitan business districts, smaller cities and suburban areas, and rural areas. LECs seeking to establish more than three zones shall be subject to increased scrutiny and must carefully justify the number of zones proposed in their density pricing zone plan.

area, assigning each of their central offices to one of the zones.[414] In filing such a proposal, LECs are to make a showing that the assignment of central offices to each of the zones reflects cost-related characteristics, such as traffic density or some measure of traffic through each office.[415] Geographic contiguity may also be considered in order to reflect exchange area boundaries or communities of interest, but should be a less important factor.

**180.** The LECs are to file and obtain approval of their density pricing zone plans in advance of filing tariff changes implementing these measures.[416] The LECs should file illustrative tariff pages when they file their density pricing zone plans, but the illustrative tariffs need not reflect rate levels. LECs that file consolidated access tariffs for multiple study areas may also file consolidated density pricing tariff revisions applicable to all of their study areas that qualify for implementation of these measures.[417] The requirement for review of density pricing zone plans is not intended to cause delay in the implementation of LEC pricing flexibility, however, and plans that reflect the standards adopted herein will be processed expeditiously.[418] Once the pricing plans have been approved, the LECs may file implementing tariff revisions on 31 days

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414 Channel terminations and other special access services should be assigned to the central office to which they are connected for purposes of defining zones. Interoffice facilities between central offices in different zones should be assigned to the highest priced zone containing one of the central offices. We believe that this classification will be consistent with traffic density patterns and underlying costs. Thus, interoffice mileage charges for service between central offices in different zones shall be rated as if the interoffice facilities were entirely within the highest priced of the zones. If they wish, LECs may use larger units, such as exchange areas, rather than central offices, in creating this system of rate zones.

415 In classifying central offices, we require that the LECs consider factors such as the density of total interstate traffic, which should reflect cost patterns more accurately than a narrower segment of traffic, such as special access alone. We require LECs to develop a method to account for both special access capacity (for which traffic is generally not measured) and switched traffic (which is typically measured).

416 We delegate authority to the Chief, Common Carrier Bureau, to consider and rule upon LECs' density pricing zone plans.

417 Implementation of density pricing plans would still be limited to those study areas in which expanded interconnection is operational.

418 In order to facilitate early review of these plans, we urge the LECs wishing to implement density pricing zones to file their plans no later than the date for filing expanded interconnection tariffs.

notice.[419] We believe that this should permit adequate time for review of the tariffs in light of our requirement that the density pricing zone plans contain illustrative tariff pages. We will not hesitate, however, to extend the effective dates of tariffs that raise significant new issues that we have not addressed in our review of the density pricing zone plans.

**181.** We will use the framework of the existing price cap system to implement the density pricing zone system for price cap LECs. For such LECs, we will create new price cap subindexes to reflect the new rate zones for DS1, DS3, and any other special access services that may be deemed subject to competition. For example, for a LEC that creates three rate zones, we will create three new subindexes for DS1 services -- one each for the high, medium, and low density zones -- and three separate subindexes for DS3 services, one for each of the zones. The initial DS1 and DS3 subindexes for each of the zones would be set at the level of the pre-existing DS1 and DS3 subindexes, respectively.

**182.** The rate bands applicable to the new, separate subindexes would employ a 5% upper band, while using a lower band of 10%. Thus, under this system, a LEC could lower prices for DS1 services in the highest density zone by as much as 10% per year adjusted for the price cap index (PCI), and could raise prices for DS1 services in the lowest density zone by no more than 5% per year adjusted for the PCI,[420] without triggering any of the additional cost justification or advance notice requirements contained in the price cap rules.[421]

**183.** The weighted average for rates in all of the zones must continue to fall within the existing 5% overall pricing bands applicable to the existing DS1 and DS3 subindexes, as well as those pricing bands applicable to the other service categories within the special access basket. Thus, the LEC could not lower the weighted average of all DS1 rates by more than 5% per year adjusted for the PCI without additional cost justification.

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419 In order to reduce administrative burdens and the potential that density zone tariffs could become effective prematurely, the LECs are not to file these tariff revisions more than 31 days before their interconnection offering becomes operational. <u>See</u> <u>supra</u> note 411. It shall be the responsibility of the LEC to extend the tariff effective dates as necessary to ensure that its density pricing zone tariff does not become effective before an interconnector has actually taken the expanded interconnection cross-connect element in the affected study area.

420 As with all bands in the price cap system, compliance with these pricing bands will be determined based on the weighted average of the rates for LEC services included within each subindex.

421 We are creating a similar system for LECs subject to the rate of return rules that implement expanded interconnection. In the case of such LECs, we will permit the rates for the same services in different zones to diverge by a maximum of 15% in the first year that these tariff revisions are in effect, 30% in the second year, and 45% in the third year.

**184.** We believe that the customer interest in increased access competition requires the Commission to give the LECs flexibility to price their special access services closer to cost in the manner we propose. Failure to change the current system of uneconomic rate averaging would seriously constrain access competition and potentially deprive customers of the attendant benefits. The safeguards that we are adopting will limit the magnitude of the rate differentials and introduce them gradually to avoid harming customers in higher cost areas. We will monitor this system closely, and we will review its application to both price cap and rate of return LECs in the autumn of 1995.[422] This will permit us to make any adjustments warranted by our initial experience with density pricing.

**185.** Although the Part 69 rules do not explicitly prohibit differential rates for loop-side and trunk-side special access, the Commission has rejected tariffs proposing such differentials on the grounds that they were not properly cost supported and discriminated between similarly situated customers.[423] As argued by Justice, greater traffic densities on trunk-side routes, and consequent cost differences, may justify differential prices for trunk-side and loop-side special access links. To a great extent, however, such differentials are already reflected in tariffed rates for special access services because most loop-side special access service is at the DS1 level or below, while most trunk-side service is at or above the DS1 level, and is therefore less costly on a per unit basis. Given the other pricing flexibility measures that we adopt today, we do not believe that this additional form of pricing flexibility is necessary or appropriate at present.

**186.** The LECs also request a number of other changes in our rules regarding special access pricing. For example, they ask that we broaden or eliminate the price cap bands for DS1 and DS3 services, eliminate the service bands within the special access basket, adopt expedited tariff review procedures, and permit them to offer individual case basis pricing arrangements in response to competitors' offerings. Although such actions would eliminate LEC pricing restrictions that are not imposed on their competitors, we decline to adopt these measures at present. The system of rate zones that we are authorizing is a major step toward allowing the LECs to price their services closer to cost and thus to respond more effectively to competition in low-cost areas. While we recognize that additional pricing flexibility may well be justified as competition develops, we believe the public interest is best served at this time by proceeding in a measured

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422 This will allow us to evaluate the results of these measures on the basis of three annual access tariff filings. This will give us a sufficient base of experience on which to review the results of density pricing, while permitting us to correct any problems that might develop before there is a potential for significant harm.

423 <u>Investigation of Access and Divestiture Related Tariffs</u>, 97 FCC 2d 1082, 1099-1103, 1252-59 (1984). <u>See also</u> <u>Private Line Rate Structure and Volume Discount Practices</u>, 97 FCC 2d 923, 923-24, 926-32, 947 (1984).

fashion, reserving the question of broader pricing and rate structure flexibility for future proceedings.

### 2. Volume and Term Discounts

187. Notice. We stated that it may be appropriate to consider establishment of new guidelines for review of LEC rate structure responses to competition, such as volume discounts.[424]

188. Comments. Some IXCs argue that the LECs' existing pricing flexibility under price caps is excessive, and that the LECs are engaging in anti-competitive conduct such as unjustified volume and term discounts.[425] On May 27, 1992, MFS filed a lengthy ex parte alleging that LEC volume and term discounts and use of hubbing arrangements for high capacity special access services are not cost justified.[426] MFS also alleges that certain of these volume and term discounts are predatory and contends that they merely replace individual case basis pricing, which the Commission has rejected, as a means by which LECs discriminate among their customers. MFS argues that hubbing arrangements essentially offer large customers substantial discounts, by giving them inexpensive DS3 pricing for services provided over the same network facilities, and sold to other customers, as DS1 service.[427]

189. MFS alleges that the LECs are using volume and term discounts and hubbing arrangements to lock up the largest customers before expanded interconnection requirements take effect and prospective competitors have a chance to introduce their offerings. MFS also argues that volume and term discounts and hubbing arrangements unreasonably discriminate in favor of the largest IXCs and thus undermine interexchange competition.[428] In addition, MFS opposes LEC ratcheting of switched and special access traffic,[429] arguing that this undermines the potential for switched access competition.

190. MFS proposes restrictions on LEC pricing flexibility, including a prohibition on term discounts and "ratcheting" arrangements until

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424 Notice, 6 FCC Rcd at 3266, ¶ 45.

425 MCI Comments at 28-29; WilTel Reply Comments at 14; CompTel Reply Comments at 9-19 (arguing for separate caps on individual special access subelements and no upward pricing flexibility for subelement rates).

426 Hubbing allows a customer to interconnect high capacity services of different bandwidths through multiplexing. For instance, instead of using point-to-point DS1 services, a customer may achieve greater economies of scale by using a hubbing arrangement consisting of DS1 channel terminations, multiplexing, and DS3 interoffice transmission.

427 MFS Ex Parte at 2-3 (May 27, 1992).

428 Id. at 31.

429 See supra ¶ 105 (defining ratcheting).

expanded interconnection is in effect for both special access and switched transport. In the alternative, MFS proposes that the Commission give customers a "fresh look" opportunity, once expanded interconnection becomes effective, to terminate long-term commitments entered into with the LECs. In addition, MFS proposes that the Commission establish guidelines requiring that the LECs, on a going forward basis, cost justify term discounts over 10%, volume discounts over 20%, and hubbing discounts of any amount.[430] MFS argues, citing the LEC Price Cap Order, that the relief it seeks would be consistent with the Commission's intent in price caps that rates not be unreasonably discriminatory.[431]

**191.** The LECs contend that term and volume pricing plans existed before the initiation of this proceeding.[432] They contest MFS's allegations that LEC pricing of high capacity services is predatory and argue that MFS has not shown that prices are below incremental cost.[433] Ameritech argues that many discount arrangements were justified on the basis of fully distributed costs in filings before the Commission prior to price caps, while LEC compliance with the price cap rules has addressed the concerns of LEC competitors since that time.[434]

**192.** More specifically, the LECs argue that term discounts reflect the lower costs of long-term supply relationships with the assurance of fixed-cost recovery.[435] GTE contends that a "fresh look" period for term agreements is inappropriate; both parties to a term agreement derive benefits -- the customer gets a lower price and rate stability, while the carrier gets reductions in risk and administrative costs.[436] Ameritech states that it allows customers to cancel term arrangements at any time by

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430 MFS Ex Parte at 46-53 (May 27, 1992).

431 Id. at 27-29, 38-41.

432 See, e.g., Bell Atlantic Ex Parte at 1 (June 12, 1992); BellSouth Ex Parte at 4, 6 (June 15, 1992); NYNEX Ex Parte at 1 (June 12, 1992); SW Bell Ex Parte at 15-17 (June 12, 1992); U S West Ex Parte at 3-4 (June 19, 1992).

433 See, e.g., Bell Atlantic Ex Parte at 2 (June 12, 1992); Ameritech Ex Parte at 2 (June 12, 1992); BellSouth Ex Parte at 2 (June 15, 1992); SW Bell Ex Parte at 18-19 (June 12, 1992); United Ex Parte at 13 (June 15, 1992); Pacific Ex Parte at 2-3 (June 17, 1992); U S West Ex Parte at 5 (June 19, 1992).

434 Ameritech Ex Parte at 2 (June 12, 1992). See also GTE Ex Parte at 7 (June 15, 1992).

435 See, e.g., Bell Atlantic Ex Parte at 3 (June 12, 1992); Ameritech Ex Parte at 2 (June 12, 1992); U S West Ex Parte at 14-15 (June 19, 1992).

436 GTE Ex Parte at 30, 33 (June 15, 1992).

simply paying the charges that would have applied to a shorter term.[437]

193. The LECs also argue that volume discounts and hubbing arrangements in the pricing of high capacity services are the result of more efficient service configurations.[438] NYNEX and U S West contend that in arguing that DS3 services to an IXC POP should be priced no lower than DS1 point-to-point services, MFS ignores information demonstrating that transmission costs decline directly with increased volumes of DS3 circuits to a particular customer premises.[439] Pacific states that price reductions reflected the declining investment required to provision fiber optic facilities.[440] The LECs contend that hubbing arrangements reflect the economies of multiplexing concentrated traffic onto high capacity transmission facilities.[441] Pacific argues that without hubbing, large customers would simply bypass Pacific's network.[442]

194. According to the LECs, the Commission required ratcheting as a way of reconciling its rules that treat switched access transport and special access transport differently, even though they both are provided over the same facility.[443] The LECs argue that ratcheting allows more efficient use of the public network by permitting customers to make the most efficient use of the highest volume transport facility that suits their needs.[444]

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437 Ameritech Ex Parte at 2 (June 12, 1992). The LECs also contend that term plans were implemented in response to requests from customers who needed rate stability for planning and budgeting purposes. BellSouth Ex Parte at 6 (June 15, 1992); Bell Atlantic Ex Parte at 4 (June 12, 1992); United Ex Parte at 11 (June 15, 1992).

438 See, e.g., BellSouth Ex Parte at 2-3 (June 15, 1992); SW Bell Ex Parte at 35-36 (June 12, 1992); GTE Ex Parte at 14-17 (June 15, 1992).

439 NYNEX Ex Parte at 2 (June 12, 1992); U S West Ex Parte at 9-12 (June 19, 1992).

440 Pacific Ex Parte at 5 (June 17, 1992). United argues that discounts of up to 75.63% for 12 DS3s on a five-year term compared to a single DS3 on a month-to-month term may not be unreasonable. United Ex Parte at 13 (June 15, 1992).

441 See, e.g., Bell Atlantic Ex Parte at 3 (June 12, 1992); SW Bell Ex Parte at 35 (June 12, 1992); United Ex Parte at 4 (June 15, 1992).

442 Pacific Ex Parte at 11 (June 17, 1992).

443 See, e.g., Bell Atlantic Ex Parte at 3 (June 12, 1992); BellSouth Ex Parte at 5-6 (June 15, 1992); SW Bell Ex Parte at 26-30 (June 12, 1992).

444 See, e.g., Bell Atlantic Ex Parte at 3 (June 12, 1992); United Ex Parte at 8 (June 15, 1992); U S West Ex Parte at 7-8 (June 19, 1992). Pacific states that the importance of ratcheting is exaggerated and that only 0.47% of its special access traffic was provided pursuant to tariff

**195.** The LECs' attack MFS's proposed restrictions on LEC discount pricing as totally arbitrary and unjustified. Bell Atlantic and Pacific specifically contend that MFS offers discounts that are substantially similar to those offered by the LECs.[445] Some of the LECs assert that MFS is really seeking reconsideration of the Commission's price cap orders.[446] SW Bell argues that MFS would require that the LECs, seeking to offer discounts beyond its proposed limits, provide exhaustive cost support that price caps were designed to eliminate.[447] GTE argues that when LECs modify their relative rates, they are doing precisely what price caps permit: adjusting rates to respond to market signals and achieve more efficient price relationships.[448] The LECs also argue that pricing flexibility is needed to permit customers to realize the benefits of competition.[449] According to Bell Atlantic, the higher the FCC forces the LECs to keep their prices, the greater the margins MFS can earn while still beating LEC prices.[450]

**196.** A number of commenters responded to the LECs' filings concerning volume and term discount arrangements. MFS argues that the LECs base their arguments on the false premise that high capacity special access is fully competitive, when LEC practices are actually having an anticompetitive effect on the interstate access market.[451] Bay Area Teleport argues that the LECs' willingness to leverage their monopoly power in the competitive marketplace makes symmetric regulation between LECs and CAPs inappropriate.[452] IDA argues that the Commission should review LEC discounting practices and establish guidelines to ensure that rates for high

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provisions for shared use. Pacific Ex Parte at 14 (June 17, 1992).

445 Bell Atlantic Ex Parte at 1-2 (June 12, 1992); Pacific Ex Parte at 6 (June 17, 1992).

446 See, e.g., Ameritech Ex Parte at 2 (June 12, 1992); Pacific Ex Parte at 1-2 (June 17, 1992); GTE Ex Parte at 24-26 (June 15, 1992).

447 SW Bell Ex Parte at 36 (June 12, 1992).

448 GTE Ex Parte at 26 (June 15, 1992). See also GTE Ex Parte at 1-5 (Sept. 4, 1992); U S West Ex Parte at 1-4 (Sept. 4, 1992).

449 See, e.g., SW Bell Ex Parte at 40 (June 12, 1992); U S West Ex Parte at 16-17 (June 19, 1992); GTE Ex Parte at 5 (June 15, 1992).

450 Bell Atlantic Ex Parte at 6 (June 12, 1992).

451 MFS Ex Parte at 3 (July 8, 1992).

452 Bay Area Teleport Ex Parte at 1 (July 1, 1992). See also Intermedia Ex Parte at 1 (Aug. 26, 1992) (supporting MFS's position); Electric Lightwave Ex Parte at 1-9 (Aug. 13, 1992) (alleging that LECs have gained unfair competitive advantages using volume and term discounts).

capacity special access services are reasonable.[453] MetroComm argues that the LECs' extraordinary discounts on high capacity special access services without reliable cost data constitutes a prima facie case for investigation by the Commission.[454] The Bankers support MFS's "fresh look" proposal, but argue that the Commission should not put any limits on discount arrangements.[455] In its comments, WilTel also proposes that the Commission require LECs to alter their rate structure for non-recurring charges so that no cancellation fees are charged to persons who terminate LEC service in order to take service provided using expanded interconnection.[456]

197. ALTS argues that the Commission should initiate a full investigation of LEC volume and term discounts as well as impose a moratorium on further discounts until central office collocation is achieved.[457] ALTS also argues that the Commission should suspend LEC termination liability provisions for a period of time after expanded interconnection becomes effective.[458]

198. Teleport also made an ex parte filing, alleging the existence of additional barriers to entry. First, it argues that LECs frequently apply discriminatory nonrecurring charges when customers terminate the use of LEC circuits and move the traffic to CAP facilities.[459] Second, Teleport argues that LECs are attempting to "lock up" the access market by charging high termination penalties to special access customers who seek to end long-term arrangements, or by pricing month-to-month services at very high rates relative to long-term arrangements to force customers to use long-term arrangements.[460]

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453 IDA Ex Parte at 6 (July 23, 1992).

454 MetroComm Ex Parte at 8 (July, 1992).

455 Bankers Ex Parte at 2, 3-4, 7 (July 2, 1992).

456 WilTel Comments at 28.

457 ALTS Ex Parte at 11-2 (Sept. 9, 1992).

458 Id. at 12-13.

459 Teleport Ex Parte at 2-3 (July 10, 1992).

460 Id. at 4. Teleport also argues that LECs should be required to change its Centrex pricing practices. According to Teleport, LECs currently charge Centrex customers for two channel terminations, even though the LECs only provide one, by treating the Centrex switch located within the LEC central office as if it were located at the user's premises. Teleport contends that if the LECs are permitted to continue imposing the second channel termination charge, Centrex users will pay a substantial penalty when purchasing a CAP-supplied link between the central office and IXC POP. Id. at 5-6.

199. Discussion. In its ex parte filing, MFS alleges that many LEC volume and term discounts, as well as hubbing and ratcheting arrangements, are unreasonable and discriminatory. The LECs counter these allegations at considerable length. We conclude that hubbing and ratcheting arrangements are reasonable means of permitting customers flexibility in structuring their leased special access networks, and allowing the LECs to engineer their access networks efficiently using higher capacity facilities.[461] We also conclude that reasonable volume and term discounts can be a useful and legitimate means of pricing special access services to recognize the efficiencies associated with larger volumes of traffic and the certainty of longer term deals.

200. The largest of the volume and term discounts cited by MFS, some of which may result in total discounts of more than 70%, however, may be anticompetitive or raise questions of discrimination. Although some of the LECs contend that their volume and term discounts are cost justified. The record before us now does not permit us to make definitive determinations concerning the lawfulness of specific discounts. In light of the growing emergence of access competition, we conclude that the largest of the discounts offered by the LECs warrant some additional inquiry to help us determine whether we should promulgate guidelines requiring cost justification of any subset of LEC volume and term discounts.[462] Accordingly, we direct the Chief, Common Carrier Bureau to require the submission of cost support data for some of the largest existing discounts.[463]

201. The existence of certain long-term access arrangements also raises potential anticompetitive concerns since they tend to "lock up" the access market, and prevent customers from obtaining the benefits of the new, more competitive interstate access environment. To address this, we conclude

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461 The Commission mandated that the LECs continue to offer ratcheting. Investigation of Access and Divestiture Related Tariffs, 97 FCC 2d 1082, 1225, 1282 (1984).

462 For example, MFS cites the following LEC offerings: (1) Bell Atlantic -- 76% discount for optical DS3; (2) Pacific Bell -- 67% discount for electrical DS3; (3) Ameritech -- 66% discount for electrical DS3; and (4) U S West -- 66% discount for optical DS3. MFS Ex Parte, Exh. A at 2 (May 27, 1992).

463 This further examination of the largest existing LEC discounts reflects our commitment to guard against possible anticompetitive abuse under our current pricing rules. Contrary to the arguments of some parties, however, such possible abuse should not stand in the way of reforming our rules on LEC pricing by eliminating non-cost-based regulatory constraints with the implementation of expanded interconnection. See supra ¶¶ 172-86. This will permit LECs to respond to increasing market pressures through a combination of zone pricing differences and legitimate volume and term discounts. Our commitment to protect against anticompetitive pricing will remain under these new pricing rules.

that certain LEC customers with long-term access arrangements should be permitted to take a "fresh look" to determine if they wish to avail themselves of a competitive alternative.[464] This right will be limited to customers with LEC arrangements for terms in excess of three years entered into on or before the date of adoption of this Order.[465] The right to end a long-term arrangement at a specific central office will exist for a period of 90 days from the date the first expanded interconnection arrangement is operational in that central office.

202. If a party chooses to terminate a long-term arrangement within this period, the termination charge will be limited. Notwithstanding any termination charges provided in the applicable LEC tariffs, the LEC may not charge more than the difference between (1) the amount the customer has already paid and (2) any additional charges that the customer would have paid for service if the customer had taken a shorter term offering corresponding to the term actually used,[466] plus interest at the prime rate.[467] This termination procedure will allow special access customers with

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464 This does not give a LEC the right to cancel a long-term arrangement that a customer wishes to continue. Given that these measures will be applicable only to the IXCs and other large, sophisticated users, and the CAPs' incentive to bring this opportunity to the attention of potential customers, we do not believe that it is necessary to require customer notification by the LECs.

465 This will restrict the opportunity for a "fresh look" to customers who would otherwise be unable to seek a better deal for a significant period of time, and treat customers entering into long term arrangements with the LECs after adoption of this Order as having chosen to do so despite the impending competitive developments.

466 Ameritech states that it already has a similar policy for its long-term arrangements. Ameritech Ex Parte at 1 (June 12, 1992). For example, consider a customer who purchased DS3 services from a LEC for a 10 year term at $10,000 per year per channel, and then after 3 years of the term, competitive interconnected services became available. The LEC would have charged $12,000 per year for the same services for a 3 year term. In this case, the termination liability would be limited to the difference between what the customer would have paid under the shorter term ($12,000 x 3 years = $36,000) and what the customer actually paid ($10,000 x 3 years = $30,000). Thus, the LEC could not charge the customer more than $6,000 ($36,000 - $30,000 = $6,000), plus appropriate interest. When the actual service period does not precisely coincide with an existing service term, the charges for the service used are to be calculated at the rates applicable at the time the service term began, for the longest term commitment that the customer would have completed. The charge for the period beyond that term is to be calculated pro rata at the rates applicable to the completed term.

467 Interest rates are to be adjusted to reflect changes in the prime rate and will apply to the balances due under the recalculation as they would have accrued over time. This procedure is designed to put both the LEC and

long-term arrangements to select among competitive providers of access service, while ensuring that the LEC obtains the compensation appropriate for the term actually taken by the customer.[468]

203. We also conclude that non-recurring reconfiguration charges must be applied in a neutral manner that does not differentiate based on whether the customer chooses to use a CAP or LEC facilities for special access service unless there are specific, identifiable cost differences. Absent even-handed treatment, non-recurring reconfiguration charges could constitute a serious barrier to competitive entry.[469]

### 3. Distance Sensitivity

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the customer in the same position that they would have been in had the customer opted for a shorter term arrangement from the beginning of the service term.

468 The Commission has adopted similar "fresh look" requirements in the past. See Competition in the Interstate Interexchange Marketplace, Memorandum Opinion and Order on Reconsideration, 7 FCC Rcd 2677, 2681-82 (1992) (Interexchange Reconsideration Order) ("fresh look" in context of 800 bundling with interexchange offerings). See also Amendment of the Commission's Rules Relative to Allocation of the 849-851/894-896 MHz Bands, Memorandum Opinion and Order on Reconsideration, 6 FCC Rcd 4582, 4583-84 (1991) (Air-Ground Radiotelephone Service Reconsideration Order) ("fresh look" requirements imposed as condition of grant of Title III license). We believe that LEC termination charges in excess of those specified herein would, if allowed to continue, deprive customers of the benefits of competition and tend to "lock up" the interstate special access market. Therefore, we find that continuation of such termination provisions without the modifications specified herein would be unjust and unreasonable in violation of the Communications Act. Accordingly, we prescribe the termination measures described herein, including the maximum just and reasonable charges for the customers specified. Sections 201-205 of the Communications Act empower the Commission to adopt rules and regulations concerning the reasonableness of tariffed LEC offerings, including termination charge provisions. Moreover, the Commission may take this step consonant with Section 205 of the Act. The parties have been on notice, and have had full opportunity to comment, on our intent to examine "whether to establish new guidelines for review of rate structure responses to competition, such as volume discounts . . . ." Notice, 6 FCC Rcd at 3266, ¶ 45.

469 We decline to address the Centrex pricing issue raised for the first time by Teleport in its July 10, 1992 ex parte filing. The pricing of interstate services configured using Centrex switches raises complex policy questions, and has traditionally been the subject of controversy over the years. As a result, we will not mandate any changes in access pricing for Centrex services when no other parties have addressed the issue. Teleport, of course, is free to raise this issue in another context.

**204.** Notice. In a supplemental notice, we requested comments on distance sensitivity in the LECs' special access rates.[470]

**205.** Comments. CompTel and other non-dominant IXCs allege that there is far more distance sensitivity in LEC special access rates than is justified by costs, and that there are unwarranted differences in the degree of distance sensitivity in rates for various services.[471] They argue that excessive distance sensitivity raises transmission costs for non-dominant IXCs, gives IXCs and CAPs incentives to make inefficient network investments, and gives AT&T discriminatory competitive advantages.[472] The non-dominant IXCs ask the Commission to require that all LEC special access rates be no more distance sensitive than DS3, the least distance sensitive service.[473]

**206.** Sprint asks that the Commission require the BOCs to identify the equipment costs recovered by the various DS3 rate elements so that the inconsistencies in the BOCs' allocation and recovery of interoffice transmission costs can be explained, and if unjustified, remedied.[474] MCI asserts that total service long-run incremental cost (TS-LRIC) studies should be the basis of any distance sensitivity in the LECs' special access rate structures.[475] MCI argues that non-direct costs, including common costs, subsidies and unamortized historical costs, should be allocated equally among special access links, and not in proportion to direct costs, since the latter would result in an unfair over-allocation of such costs to IXCs with longer links that have higher direct costs.[476]

**207.** The CAPs argue that existing LEC pricing flexibility under price caps enables LECs to manipulate the prices of distance sensitive rate elements strategically, depending on whether they face competition from CAPs in given areas.[477] MFS, ALTS and Teleport propose that the Commission reduce the amount of pricing flexibility that LECs now have under price caps by

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470 Expanded Interconnection with Local Telephone Company Facilities, Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 5809 (1991).

471 CompTel Supp. Comments at 6-10; CompTel Supp. Reply Comments at 4-6 & App. A; WilTel Supp. Comments at 5-12; WilTel Supp. Reply Comments at 5-8; Sprint Supp. Comments at 2-4.

472 CompTel Supp. Comments at 10-12; MCI Supp. Comments at 3-4; WilTel Supp. Comments at 16-24.

473 CompTel Supp. Comments at 12-14; WilTel Supp. Comments at 15.

474 Sprint Supp. Comments at 7.

475 MCI Supp. Comments at 3, 6. See supra ¶ 168.

476 MCI Supp. Comments at 8-9 n.16.

477 MFS Supp. Comments at 2-5; ALTS Supp. Comments at 3-4; Teleport Supp. Comments at 3.

establishing separate subindexes for the distance sensitive rate elements in their special access rates.[478] They submit that the Commission should require the LECs to reflect the distance-sensitive component of their transport rates in a separate, uniform rate element, such as a uniform rate per mile, and to demonstrate that the rate structure is cost justified.[479] Teleport Denver argues that distance-insensitive and traffic-sensitive special access rates would facilitate network efficiencies, discourage cross-subsidization, promote reliability, and facilitate interexchange and local access competition.[480]

**208.** The Tier 1 LECs respond that distance continues to be a significant factor affecting the cost of special access facilities, and that even the cost of fiber facilities is distance sensitive.[481] They argue that there is no need for the Commission to take any action restraining LECs' special access pricing, that the degree of distance sensitivity in their special access rates is cost-justified, and that competitors' calls for additional cost studies or justification constitute nothing more than an attempt to place additional regulatory burdens on them and to reargue the merits of price caps.[482] Although they admit that fiber facilities are less distance sensitive than copper facilities, the LECs state that their rates are distance sensitive in part because they are based on study area-wide averaged rates that include the embedded cost of copper-based facilities.[483] GTE states that costs are not distributed evenly per mile, but are "lumpy."[484] In addition, several of the LECs contend that there is no basis for a uniform degree of distance sensitivity among LECs or between different

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478 MFS Supp. Comments at 11; ALTS Supp. Comments at 5-6; Teleport Supp. Comments at 4.

479 MFS Supp. Comments at 6-10; Teleport Supp. Comments at 4; ALTS Supp. Comments at 4-5.

480 Teleport Denver Supp. Comments at 2-7; Teleport Denver Supp. Reply Comments at 3-5.

481 Ameritech Supp. Comments at 3-4; Centel Supp. Comments at 2-4; Cincinnati Bell Supp. Comments at 2-4; GTE Supp. Reply Comments at 2-6; NYNEX Supp. Comments at 2-4; Rochester Supp. Comments at 4; SW Bell Supp. Comments at 2-3; USTA Supp. Comments at 2; U S West Supp. Comments at 5-7.

482 Bell Atlantic Supp. Comments at 1-3; BellSouth Supp. Comments at 3-4; Centel Supp. Comments at 5; NYNEX Supp. Comments at 5; USTA Supp. Comments at 1; Ameritech Supp. Reply Comments at 4-7; BellSouth Supp. Reply Comments at 5-6; GTE Supp. Reply Comments at 14-17; Pacific Supp. Reply Comments at 23-30; U S West Supp. Reply Comments at 6-7.

483 Centel Supp. Comments at 3-4; NYNEX Supp. Comments at 2-3; Pacific Supp. Comments at 4-5; SNET Supp. Comments at 2; SW Bell Supp. Comments at 3-5; GTE Supp. Reply Comments at 6-8.

484 GTE Supp. Reply Comments at 3.

types of transmission services.[485]

**209.** The LECs assert that when expanded interconnection for special access is implemented, they will be unable to overstate the distance sensitive cost of channel mileage because CAPs and IXCs will be able to install alternative transmission facilities to the LECs' central offices.[486] The LECs counter the argument about the impact on interexchange competition, contending that distance sensitivity is cost justified and therefore in the public interest even if distance sensitive rates affect the IXCs differently. They assert that an artificial rate structure shielding less efficient providers would deny consumers the benefit of AT&T's network efficiencies.[487] Finally, the LECs argue that the Commission should adhere to price cap principles and grant the LECs additional pricing flexibility in order to compete.[488]

**210.** GSA agrees with the IXCs' and CAPs' argument that excessively distance sensitive transport rates have a negative impact on both local access competition and interexchange competition. It supports requiring LECs to cost justify the level of distance sensitivity in their rates.[489] Small LECs, on the other hand, submit that they should be allowed to retain distance sensitivity in their special access rate structures. They argue that LECs' interoffice facilities vary widely based on individual company circumstances, that most NECA pool members do not have any fiber optic

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485 USTA Supp. Comments at 2; U S West Supp. Comments at 5-7; Rochester Supp. Reply Comments at 3-5; NECA Supp. Comments at 2-3.

486 BellSouth Supp. Comments at 4; GTE Supp. Reply Comments at 13; NYNEX Supp. Comments at 4-5; Rochester Supp. Reply Comments at 2-3; SW Bell Supp. Comments at 11-12.

487 Ameritech Supp. Comments at 9-10; BellSouth Supp. Comments at 4-5; SW Bell Supp. Comments at 9; USTA Supp. Comments at 3.

488 Ameritech Supp. Comments at 5; Ameritech Supp. Reply Comments at 8-11; Bell Atlantic Supp. Comments at 2; GTE Supp. Comments at 4-6; GTE Supp. Reply Comments at 12-13; NYNEX Supp. Reply Comments at 6-11; SW Bell Supp. Comments at 11, 14; SW Bell Supp. Reply Comments at 11-12; Pacific Supp. Comments at 6-10. See also USTA Supp. Comments at 1-2, 4 (LECs are voluntarily reducing distance sensitivity in their access rates); Pacific Supp. Comments at 5 (same); United Supp. Comments at 2-3 (distance is a less important cost driver as volume or density increases); Consolidated Supp. Comments at 2-3 (same); Ameritech Supp. Comments at 7-8 (CompTel's analysis is flawed, as rates for various types of switched and special access increase only by factors of 1.5 to 2.5 as distance increases from one to fifty miles); NYNEX Supp. Reply Comments at 3-5 (CompTel demonstrates only the cost efficiencies of high capacity transmission, and not relative distance sensitivity); U S West Supp. Comments at 4; U S West Supp. Reply Comments at 3-4 (LEC channel termination rates should contain distance sensitivity).

489 GSA Supp. Reply Comments at 3-9.

facilities, and that a non-distance sensitive rate structure would provide uneconomic incentives for IXCs to reduce the number of POPs, which could result in stranded investment.[490]

211. California asserts that at least in California, the distance sensitivity of LECs' intrastate rates for transport and special access are cost-supported and non-discriminatory.[491] D.C. supports the use of distance-sensitive charges and differential pricing based on routing.[492]

212. Discussion. Based on the current record, we see no reason to restrict, as a general proposition, the degree of distance sensitivity in LEC rates for different special access services. Various special access services -- and various LECs -- use different mixes of copper and fiber optic plant, which have different cost characteristics insofar as distance sensitivity is concerned. Given the underlying cost characteristics, it is not surprising that there are differences in the distance sensitivity of rates for different services and differences in the distance sensitivity of comparable service offerings by different LECs. In addition, we concluded in the LEC Price Cap Order[493] that allowing the LECs a degree of pricing flexibility would foster efficiency.

213. We do not believe that the record supports CompTel's proposal to require that LEC rates for all special access service categories be no more distance sensitive than DS3, the least distance sensitive special access service. In fact, it appears that rates for other services can reasonably reflect greater distance sensitivity than the charges for DS3. DS3 is provided almost exclusively over fiber optic facilities, for which the cost is substantially less distance sensitive than copper cable. DS1 and lower capacity services, however, are often provided over copper facilities. Given the averaging of LEC rates, it is reasonable to expect that rates for these services would often be more distance sensitive than those for DS3.

214. The importance of distance sensitivity also appears to be declining, since certain of the LECs are reducing the degree of distance sensitivity in their rate structures as the proportion of fiber increases.[494] Competitive pressures should also tend to bring the distance

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490 NECA Supp. Comments at 2-3; NTCA Supp. Reply Comments at 3-5; Consolidated Supp. Comments at 1-4.

491 California Supp. Comments at 2.

492 D.C. Comments at 2-3.

493 Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786 (1990), recon., 6 FCC Rcd 2637 (1991), further recon., 6 FCC Rcd 4524 (1991), second further recon., 7 FCC Rcd 5235 (1992), pet. for review pending sub nom. National Rural Telecom Ass'n v. FCC, No. 91-1300 (D.C. Cir., filed June 26, 1991).

494 USTA Supp. Comments at 1-2, 4; Pacific Supp. Comments at 5.